IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-1253

LESLIE W. NIMMO, et al.,
Petitioners,
(Defendants Below),

v.

CHARLES S. GRAINGER, et al.,
Respondents
(Plaintiffs Below).

BRIEF IN OPPOSITION TO CERTIORARI

J. VERNON PATRICK, JR.
RICHARD NORTH PATTERSON
THOMAS J. GALLO
BERKOWITZ, LEFKOVITS & PATRICK
1400 City National Bank Building
Birmingham, Alabama 35203
JAMES W. MAY
1122 North 22nd Street
Birmingham, Alabama 35234
Attorneys for Respondents
(Plaintiffs Below)

St. Louis Law Printing Co., Inc., 812 Olive Street 63101 314-231-4477

TABLE OF CONTENTS

Page

Authorities Cited iii

Cases Cited iii

Statutes and Rules Cited v

Other Authorities Cited vi

Questions Presented for Review by This Court 2

Statutes Involved 4

Statement of the Case 5

A. The Facts 5

B. Proceedings in the District Court 7

C. The Panel Decision of February 15, 1977 10

D. The Fifth Circuit's May 25, 1977 Order Granting Rehearing En Banc and Subsequent Order of November 17, 1977 Vacating the May 25, 1977 Order 12

E. The Panel's November 17, 1977 Opinion 12

Argument 14

I. This Case Is Not Ripe for Review, as the Court of Appeals Has Simply Remanded the Case to the District Court for Reconsideration in Light of Facts Previously Excluded From Consideration. Moreover, in Leaving the Initial Decision to the District Court, the Court of Appeals Has Followed Established Precedent 14

II. Ample Authority Supports the Panel's February 18 Holding That the Parol Evidence Rule Cannot Be Applied in This Case to Bar the Receipt of Evidence of Oral and Written Representations .. 17

III. The Decision of the Court of Appeals Below Is Not in Conflict With the Tenth Circuit's Decision in Olpin v. Ideal National Insurance Co., 419 F.2d 1250 (10th Cir. 1969), cert. denied, 397 U.S. 1074 (1970) 21

IV. The Concerns Expressed by Defendants in Their Petition for Certiorari With Respect to Whether Standard Insurance, Endowment, and Annuity Contracts Must Be Registered With the SEC, and With Respect to Overlapping SEC and State Regulation, Are Based on a Misunderstanding of Congressional Intent and of the Extent of the Overlap 22

V. The Decision Below Is Wholly Consistent With This Court's Prior Decisions; the McCarran-Ferguson Act (Adopted in 1945) Does Not Bar the Application of the Federal Securities Laws to the "Variable Investment Plan" Contracts Sold Plaintiffs in This Action 26

A. McCarran-Ferguson Is Not Dispositive of the Factual Questions Presented in This Action: Are the V.I.P. Contracts Merely "Insurance Contracts?" Do They Only Involve the "Business of Insurance"? 28

B. The 1933, 1934 and 1940 Acts Expressly Deal With the Business of Insurance 30

C. The 1933 and 1934 Acts Are Cumulative to State Regulation and Do Not "Supersede, Impair or Invalidate" State Laws Regulating or Taxing the Business of Insurance 32

VI. This Case Is Not of Such Importance as to Require Review by This Court Because It Involves a

"Specialty," Non-Standard Contract With Special Provisions Which the States Have Prohibited Since 1967 34

VII. State Remedies and State Regulation Are Inadequate 34

A. State Regulation of Investments by Insurance Companies Is Not Uniform and Has Not Prevented Failures of Insurance Companies and Misuse of Other People's Money by Insurance Companies and Promoters 35

B. The Civil Remedies Available to Plaintiffs Under State Law Are Inadequate 40

C. Many States Do Not Compel Adequate Disclosure 41

Conclusion 43

Certificate of Service 44

Authorities Cited

Cases

Arnstein v. Porter, 154 F.2d 464 (2d Cir. 1946) 15

Birmingham Post Co. v. Brown, 217 F.2d 127 (5th Cir. 1955) 15

Brotherhood of Locomotive Firemen & Enginemen v. Bangor & Aroostock R. R. Co., 389 U.S. 327 (1967) . . 14

Commercial Cas. Ins. Co. v. Hosey, 238 Ala. 335, 191 So. 343 (1939) 19

Dowell v. Jowers, 182 F.2d 576 (5th Cir. 1950) 15

Empire Dist. Elec. Co. v. Rupert, 199 F.2d 941 (7th Cir. 1953) 15

Feldman v. Bates Mfg. Co., 143 N.J. Super. 84, 362 A. 2d 1177 (1976) 40

Ginzburg v. United States, 383 U.S. 463 (1966) 10

Goodman v. H. Hentz & Co., 265 F.Supp. 440 (N.D. Ill. 1967) 18

Grainger v. State Sec. Life Ins. Co., 547 F.2d 303 (5th Cir. 1977) 10, 11

Kansas City Life Ins. Co. v. Cox, 104 F.2d 321 (6th Cir. 1939) 20

McDonald v. Kershaw, Butler Engineers, Ltd., 172 F.2d 798 (5th Cir. 1949) 15

Olpin v. Ideal National Ins. Co., 419 F.2d 1250 (10th Cir. 1969), cert. denied, 397 U.S. 1074 (1970) 21

Sartor v. Arkansas Natural Gas Corp., 321 U.S. 620 (1944) 15

SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943) 10, 17

SEC v. National Securities, Inc., 393 U.S. 453 (1969) 26, 28, 33

SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967) 10, 28,29, 30, 33, 42

SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959) 23, 27, 28, 29, 30, 31, 33, 42

Skinner v. White, 505 F.2d 685 (5th Cir. 1974) 36, 39

So. Bldg. & Loan Ass'n v. Dinsmore, 225 Ala. 550, 144 So. 21 (1932) 19

Supt. of Ins. as Liq. of Manhattan Cas. Co. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971) 24

Svalina v. Big Horn Nat'l Life Ins. Co., 446 P.2d 1018 (Wyo. 1970) 18

Williams v. National Sur. Corp., 257 F.2d 771 (5th Cir. 1958) 15

Statutes

Section 2(1), Securities Act of 1933, 15 U.S.C. §77b....7, 30

Section 3(a)(8), Securities Act of 1933, 15 U.S.C. §77c(a)(8) 23, 24, 25, 28, 30, 31, 40

Section 12(2), Securities Act of 1933, 15 U.S.C. §77l 4, 18, 24, 25

Section 16, Securities Act of 1933, 15 U.S.C. §77p....28, 33

Section 17(a), Securities Act of 1933, 15 U.S.C. §77q(a) 4, 18, 25

Section 17(c), Securities Act of 1933, 15 U.S.C. §77q(c) 4, 23, 24, 25, 31

Section 18, Securities Act of 1933, 15 U.S.C. §77r 28, 33

Section 3(a)(10), Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10) 8, 26, 30

Section 3(a)(12), Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10) 26

Section 10(b), Securities Exchange Act of 1934, 15 U.S.C. §78j(b) 18, 24

Section 12(g), Securities Exchange Act of 1934, 15 U.S.C. §78l(g) 23, 31

Section 28, Securities Exchange Act of 1934, 15 U.S.C. §78bb 28, 33

Section 2(a)(17), Investment Company Act of 1940, 15 U.S.C. §80a-2(a)(17) 23-24, 32

McCarran-Ferguson Act of 1945, 15 U.S.C. §1012 ....26-27, 28, 30, 31, 33, 37, 40

Rules and Regulations

Departmental Regulation No. 17, Regulations of Alabama Department of Insurance (April 20, 1967) 3, 34

Rule 12(b), Federal Rules of Civil Procedure 3, 18

Rule 56(c), Federal Rules of Civil Procedure 3

Rule 40(a), Federal Rules of Appellate Procedure 12

Other Authorities

Best's Insurance Reports, Life-Health 1960 through 1976 . . . . 36, 37

17 Couch on Insurance (2d Ed. 1967) 20

Hanson and Farney, "Life Insurance Companies: Their Promotion and Regulation," 49 Marq. L. Rev. 175 (1965) 36, 38

Hearings Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary: The Insurance Industry, 91st Cong., 1st Sess.

Statement of Joseph M. Belth, p. 553 41

Statement of Allan W. Horne, pp. 8817, 8842 . . . . 37, 38

Statement of David M. Pack, p. 9039 37

House Committee Report No. 1338 (Conference Report) 73rd Cong., 2d Sess., p. 39 18

Kimball and Hanson, "The Regulation of Specialty Policies in Life Insurance," 62 Mich. L. Rev. 167 (1963) 3, 6, 18, 41

Restatement of Contracts, §§ 233 and 238(b) 21

Stern and Gressman, Supreme Court Practice §4-19 (3d ed. 1962) 14

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-1253

LESLIE W. NIMMO, et al.,
Petitioners,
(Defendants Below),

v.

CHARLES S. GRAINGER, et al.,
Respondents
(Plaintiffs Below).

BRIEF IN OPPOSITION TO CERTIORARI

Respondents Charles W. Grainger, et al., (herein "plaintiffs") respectfully file this brief in opposition to the writ of certiorari requested by the petition for certiorari (herein "petition") filed on behalf of Leslie W. Nimmo, et al., (herein "defendants").

We shall attempt in this brief to demonstrate that the defendants have misstated the facts, the questions presented for review by this Court, and the nature of the rulings below.

We shall also attempt to demonstrate that the decision below (which remanded this action for reconsideration by

the district court) is not ripe for review by this Court; that the decision below is not (as defendants claim) in conflict with a decision of another court of appeals; and that the court of appeals has not (as defendants claim) "so far departed from the accepted and usual course of judicial proceedings . . . as to call for the exercise of this Court's power of supervision."

QUESTIONS PRESENTED FOR REVIEW BY THIS COURT

The defendants' petition erroneously describes the Great States "Variable Investment Plan" contract sold to each plaintiff as "*a life insurance policy* with a *standard* participating provision," and (at p. 3) suggests that the first question presented for review by this Court is whether such a contract can ever "become" a "security" under the Federal Securities Laws. So framed, the question posed by defendants assumes that a number of disputed and as yet undecided factual and legal issues will be determined in defendants' favor. The district court and the court of appeals have *not* held that Great States "Variable Investment Plan" contract is a "security." Instead, the court of appeals has held (1) that the district court erred in dismissing Counts 1, 2 and 3 of the complaint for failure to state a claim under the Securities Act of 1933 and the Securities Exchange Act of 1934; and (2) that the district court, in ruling on any motion for summary judgment, should not limit its consideration to the face of the instrument sold, but may also properly consider all the facts and circumstances of the offering, including written and oral sales presentations, and in addition may properly consider expert actuarial testimony with respect to the relationship between the size of the death benefits and the size of the "premiums" charged for the "Variable Investment Plan" contracts.

Defendants' petition erroneously characterizes Great States "Variable Investment Plan" contract as a "standard" insurance

contract. It is not. Notwithstanding defendant Nimmo's testimony to the contrary (App. 56), there is testimony by the Alabama sales manager for Great States to the effect that Great States attached to each "VIP" contract a mimeographed copy of an Illinois statute which stated that any company selling participating policies must keep a separate accounting and pay out 90% of its profits on such contracts. (App. 114-116, 69, 166-167). In addition, attached to each contract were "coupons" which resembled bond coupons. (App. 168).

Far from being "standard" insurance contracts, the "VIP" contracts sold to plaintiffs by Great States were "specialty" contracts, with attachments and features which have been expressly prohibited in Alabama and most other States on the ground that they tend to mislead the purchaser into thinking that he is buying an "investment." (App. 127, 64). See Departmental Regulation No. 17, Regulations of Alabama Department Insurance (April 20, 1967, effective June 1, 1967); Kimball and Hanson, "The Regulation of Specialty Policies in Life Insurance," 62 Mich. L. Rev. 167, 204 (1963).

The second question for review by this Court, according to p. 3 of defendants' petition, is whether the court of appeals below erred in treating the district court's ruling as a ruling on motion to dismiss, and instead should have treated the district court's ruling as a grant of summary judgment. The record demonstrates, however, that the district court's June 5, 1975 order dismissed Counts, 1, 2 and 3 of the complaint "for failure to state a claim." (App. 160) Thus, the district court's order of June 5, 1975 appears to have been entered pursuant to Rule 12(b), rather than Rule 56, as defendant's claim.

STATUTES INVOLVED

Defendants' petition fails to call to this Court's attention the provisions of §§ 12(2) and 17(c) of the 1933 Act. Those sections of the 1933 Act make it clear that "exempt securities" (such as U. S. bonds, municipal bonds, and any "insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner," etc.) are exempt from registration with the SEC but are *not* exempt from the *antifraud* prohibitions provided by §§ 12(2) and 17(a).

Section 17(c), 15 U.S.C. § 77q(c) states:

"Sec. 17. (c) The exemptions provided in section 3 shall not apply to the provisions of this section."

Similarly, Section 12 of the 1933 Act, 15 U.S.C. § 77l states:

"Sec. 12. Any person who—

"(1) offers or sells a security in violation of section 5, or

"(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity

in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

STATEMENT OF THE CASE

A. The Facts.

Commencing in or around 1962, the individual plaintiffs were approached by various salesmen employed by the Great States Life Insurance Company ("Great States"), an Illinois insurance company controlled by two of the defendants (L. W. Nimmo and Nimmo & Associates, Inc.), and the predecessor in interest to the defendant State Security Life Insurance Company (App. 10-11). These salesmen urged the various individual plaintiffs (and the members of the class they seek to represent) to purchase investments known as Variable Investment Plan ("VIP") contracts (App. 11). Although these VIP contracts had certain common insurance attributes, such as a guaranteed death benefit, in order to sell these contracts the plaintiffs were told by the defendants' salesmen that these VIP contracts "were * * * an investment, not insurance" (App. 166; *see also,* App. 114, 117). Indeed, the district court has found that "the salesmen treated the 'V.I.P.' * * * contract as if it were a 'security'" (App. 192). The emphasis in every sales effort was the opportunity to realize profits from the managerial efforts of the defendants. Focusing upon the non-insurance aspects of these VIP contracts, the defendants' contracts, as explained by the defendants' salesmen, were purveyed as offering the plaintiffs "as much as 40 per cent interest" on their periodic investments (App. 166).

In this regard, the profit potential of these VIP contracts takes on added significance. The actual contracts, as well as the written sales materials used to sell them, called attention to the fact that the defendants would establish a separate accounting for the benefit of all VIP contract holders (App. 115, 167). These funds were to be managed by the defendants, and at least 90 percent of the "profits" derived from the defendants' managerial efforts with these funds were to be returned to investors, in the form of periodic "dividends" (App. 69, 114, 115, 166, 167). This promise—of the establishment of a separate accounting and the payment of 90 percent of the profits to be derived from the defendants' management of VIP contract investments —was not, however, wholly gratuitous. Illinois law apparently required this promise, at least as to sales in that state. The defendants, in any event, purported to act in accordance with that statutory obligation, although their attention to statutory requirements proved to be short-lived. Soon after the sales of VIP contracts to the plaintiffs commenced, the defendants were "instructed * * * to cease selling * * * VIP [contracts] in * * *" Alabama, since these VIP contracts were of " 'a profit-sharing or investment nature' [and] had not been approved for sale in Alabama" (App. 169). Nonetheless, the defendants continued to sell these VIP contracts to the plaintiffs and others situated in Alabama and elsewhere (App. 111, 169).[1]

In July, 1966, a new dividend scale was unilaterally adopted by Great States. Under this new scale, instead of distributing 90 percent of the profits derived from its separate VIP accounts to

---

[1] Additional investment incentives were also offered—in the form of twenty-four special coupons attached to each contract. Denominated as "Guaranteed Premium Reduction Coupons," "[t]hese coupons guaranteed payments of stated amounts of cash by Great States * * * upon surrender of the coupon" (App. 168). In addition, "[p]rovisions were also made for other, more attractive benefits, if the coupons were retained" (*id.*). For a discussion of the potentially deceptive nature of coupon policies, *see Kimball & Hanson, The Regulation of Specialty Policies in Life Insurance,* 62 Mich. L. Rev. 167 (1963).

investors in VIP contracts, as it had agreed to do, Great States determined to reduce these dividend payments by almost one-half, offering investors only fifty percent of the profits derived from VIP contract payments (App. 115, 118, 168). This reduction in dividends was apparently not unanticipated by Great States—the original promise made by the defendants to pay 90 percent of their profits had deliberately been "estimated rather high *to attract new policy owners*" (App. 147). VIP investors, however, were unaware of this, and Great States took efforts to keep them uninformed.

Thus, when investors inquired about this significant reduction in dividends, Great States explained that the lowering of dividends had been recommended to it by its consulting actuaries, and was due "to an increased mortality experience along with the ever increasing costs of operations" (App. 169). In a sense, however, much of this was to prove academic, since at no time did the defendants ever establish the separate accounting entries they promised the plaintiffs they would establish (App. 170).

B. **Proceedings in the District Court.**

Faced with the forfeiture of the payments they had made if they should cease making periodic payments pursuant to their VIP contracts, on July 15, 1969, the plaintiffs instituted this action in federal district court in Alabama. In their complaint (App. 8-34), the plaintiffs basically alleged five causes of action, encompassing claims arising under the federal securities laws, principles of common law fraud and established doctrines of contract law. Only two of these causes of action, however, are relevant on this appeal.

With respect to the two causes of action relevant here, the plaintiffs allege that the VIP contracts they were sold are securities, within the meaning of both section 2(1) of the Securities Act of 1933, 15 U.S.C. 77b(1), and Section 3(a)(10) of the

Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10)—securities which were required to be, but which unlawfully were not, registered with the Commission prior to their distribution to the investing public. Similarly, the plaintiffs also allege that they were induced to purchase these securities on the basis of materially, and deliberately, false misrepresentations of fact.[2]

After some depositions and other discovery had been had, the defendants moved to dismiss this action, (App. 35, 43, 46).[3] Upon consideration of various affidavits, and the briefs and oral arguments of counsel, the district court below issued an order and memorandum, essentially finding, for purposes of the defendants' motions, the facts as set forth briefly above.[4]

Although the district court apparently concluded that

—the sales techniques employed "indicate that the [defendants'] salesmen treated the 'V.I.P.' insurance contract as if it were a 'security' " (App. 192);

—the coupons appended to the VIP contracts "might be compared to those of a bond," and "may lend themselves to abuse * * *" (App. 189); and

---

[2] The plaintiffs' complaint also alleges that

—the defendants violated the antifraud provisions of the Securities Exchange Act in connection with a merger between Great States and the defendant State Security Life Insurance Company (App. 21);

—the defendants unlawfully diverted the assets of Great States to the defendant Nimmo for his personal benefit (App. 18); and

—the defendants breached the terms of the VIP contracts they sold to the plaintiffs (App. 17).

[3] The defendants Nimmo and Associates, Inc. and L. W. Nimmo, also sought to quash service of process (App. 43, 46).

[4] The district judge filed his own order, but "the Court wholly adopt[ed] * * *" a "memorandum prepared by its law clerk * * * as its opinion" in this case (App. 159).

—sales of these VIP contracts had been ordered stopped by some states because they were investment contracts that had not been approved for sale to investors (App. 189),

the court, nevertheless placed rather heavy emphasis (App. 192) on the facts that (1) these VIP contracts included a fixed, minimum, death benefit, and (2) the profit participation feature was "denominated as a 'dividend', not as a 'security' or as an ascertainable share of an investment fund" (App. 188). As a result, the court held that, *on their face and without regard to the manner in which these contracts were sold to investors,* the VIP contracts sold to the plaintiffs appeared to be more like traditional insurance contracts than securities in the form of investment contracts. Accordingly, the court dismissed (for failure to state a claim) the plaintiffs' causes of action alleging that the VIP contracts were securities subject to the antifraud and registration provisions of the federal securities laws.[5]

In essence, the district court opined that, as a matter of law, the VIP contracts were insurance contracts, and despite the teachings of the Supreme Court—that in the enforcement of the federal securities laws "it is not inappropriate that promoters'

---

[5] The district court also

—denied the defendant State Security's motion to dismiss the breach of contract and common law fraud claims (App. 160);

—granted the motions of the defendants Nimmo and Nimmo & Associates, Inc. to dismiss the common law fraud and breach of contract claims for failure to state a claim as to these defendants (*id.*);

—denied the motions of all the defendants to dismiss the common law and federal statutory counts challenging the propriety of the 1968 merger between Great States and State Security (*id.*); and

—denied the plaintiffs' motion to certify a class as to the VIP contracts, although it reserved any ruling on class certification with respect to the counts of the complaint pertaining to the 1968 merger (App. 160-161).

offering be judged as being what they were represented to be"[6]—advertising and promotional efforts *need not* be considered where the instrument in question offers a fixed death benefit.

C. **The Panel Decision of February 15, 1977.**

The plaintiffs appealed the order of the district court insofar as it dismissed the federal securities laws counts of their complaint relating to the sale of VIP contracts, and insofar as it denied class action status to all the counts of the complaint—both federal and common law—including those involving the VIP contracts.

On February 15, 1977, a panel of the Court of Appeals for the Fifth Circuit, Consisting of Circuit Judges Godbold, Tjoflat, and McCree[7] unanimously held that the district Court should not have limited its inquiry in determining whether the VIP contracts were securities. *Grainger v. State Security Life Insurance Co.*, 547 F.2d 303 (C.A. 5, 1977). Relying upon the Supreme Court's seminal decision in *Securities and Exchange Commission v. C.M.Joiner Leasing Corp.*, 320 U.S. 344 (1943), the panel effectively held, as the Supreme Court had before it, that in determining whether an instrument is a security, it is appropriate to look "outside the instrument itself." 320 U.S. at 355.

Accordingly, although the panel expressly refrained from expressing any view as to whether the VIP contracts are securities,[8]

---

[6] *See, e.g., Securities and Exchange Commission v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 353 (1943); *Securities and Exchange Commission v. United Benefit Life Insurance Co.*, 387 U.S. 202, 211 (1967); *Cf. Ginzburg v. United States*, 383 U.S. 463, 472 (1966).

[7] Judge McCree, now Solicitor General of the United States, was, at the time of the panel decision, a member of the United States Court of Appeals for the Sixth Circuit, sitting by designation.

[8] The panel did, however, express its "substantial doubts about the significance which the district court attributed to the death benefit

it held that, while the district court's comparison of the VIP contracts with so-called "insurance" contracts held to be securities in other cases was "proper, * * * the court could not stop at this point. In making a determination of what exactly was being offered * * * it was required to consider the methods used in selling the contracts." 547 F.2d at 306. In addition, the panel instructed the district court to consider, among other things, the terms of the offering, the plan of distribution, and the economic inducements held out. *Id.*

Addressing itself to the district court's heavy reliance on the presence of a fixed death benefit in the VIP contracts, the panel also cautioned the district court to consider

> "not only * * * the amount of the death benefit but also * * * the relationship between the size of the death benefit and the size of the 'premium' payments. A showing that the 'premiums' were disproportionately high (in terms of insurance industry norms) in relation to the amount of the death benefit would be persuasive evidence that the VIP contracts were not being bought and sold * * * as insurance policies, but * * * as investment contracts."

547 F.2d at 307.

Accordingly, the panel reversed so much of the district court's decision as had dismissed the plaintiffs' complaint as it related to the VIP contracts, with directions for further proceedings—an evidentiary hearing on the plaintiffs' allegations.[9]

---

on the VIP contracts." Thus, the panel stated that the "mere presence of a death benefit of $10,000, or for that matter any given dollar amount, cannot conclusively establish that the insurance features of a particular contract are not simply window dressing on what is essentially an investment contract." 547 F.2d at 307.

[9] Because the district court had also failed to afford the plaintiffs an opportunity to prove that the defendants' alleged misrepresentations were uniform, the panel also vacated the district court's denial of class status to VIP contract holders, holding that, if the plaintiffs

D. **The Fifth Circuit's May 25, 1977 Order Granting Rehearing** *En Banc* **and Subsequent Order of November 17, 1977 Vacating the May 25, 1977 Order.**

On March 23, 1977, defendants filed a petition for rehearing *en banc*, arguing that the February 18, 1977 panel decision would subject all "participating" insurance policies to the full panoply of SEC regulation. No reply brief was filed by plaintiffs, because Rule 40(a) of the Federal Rules of Appellate Procedure provides that no answer to a petition for rehearing will be received unless requested.

On May 25, 1977 the Fifth Circuit granted rehearing *en banc* and invited plaintiffs (and later the SEC) to submit briefs. On November 17, 1977, *after* lengthy briefs and oral argument before all active judges, the court of appeals entered an *en banc* order vacating the May 25 order and remanded the case to the panel.

E. **The Panel's November 17, 1977 Opinion.**

In a brief *per curiam* opinion, on November 17, 1977, the panel stated:

> "In their petition for rehearing appellees L. W. Nimmo and Nimmo & Associates, Inc. protest that our decision means that an endowment insurance policy containing what they describe as 'a commonly used provision' for the policyholder's participating in surplus can be found to be a security by reason of methods used in its sale. This char-

---

cannot "demonstrate the existence and use * * * of" a "standardized sales pitch by all the company's salesmen," then "the district court may quite properly refuse to certify a class on the grounds that common questions of law or fact do not predominate." 547 F.2d at 307-308.

acterization of our decision is not correct. *We did not hold that participating life insurance policies in general are securities or even that the particular contracts in this case are securities. What we have held is that the district court must consider, along with the provisions of the VIP contracts themselves, the totality of the circumstances surrounding their sale, including any oral representations made, in determining whether defendants were selling securities.* [Emphasis supplied]

" 'Endowment policies' vary in their terms and provisions, and participation clauses differ also. In this instance, as pointed out in our opinion the contract in issue is named 'Variable *Investment* Plan' (emphasis added). It purports to guarantee the purchaser '90% of divisible surplus earnings.' Attached coupons physically resemble coupons often attached to bonds. Also, without indicating any views on the relationship between the size of the death benefit and the size of premium payments in the VIP contracts, we pointed out that this relationship is a proper factor for consideration by the district court (as opposed to the substantiality of the death benefit, considered in isolation) in determining whether the facial characteristics of the contracts plus the circumstances of their sale caused them to be securities.

The petition for rehearing is DENIED."

ARGUMENT

I

This Case Is Not Ripe for Review, as the Court of Appeals Has Simply Remanded the Case to the District Court for Reconsideration in Light of Facts Previously Excluded From Consideration. Moreover, in Leaving the Initial Decision to the District Court, the Court of Appeals Has Followed Established Precedent.

As stated in Stern and Gressman, *Supreme Court Practice* § 4-19 at p. 148 (3d ed. 1962):

> The Supreme Court will not usually grant certiorari to review a non-final judgment, such as one remanding the case to the district court for a new trial or one sanctioning the issuance or denial of a preliminary injunction, in the absence of some exceptional reason. As stated in *American Construction Co. v. Jacksonville, T. & K. R. Co.*, 148 U.S. 372, 384, "this court should not issue a writ of certiorari to review a decree of the circuit court of apepals on appeal from an interlocutory order, unless it is necessary to prevent extraordinary inconvenience and embarrassment in the conduct of the cause." See *Youngstown Co. v. Sawyer*, 343 U.S. 579, 584-5; *Cobbledick v. United States*, 309 U.S. 323, 324-5; *Hamilton-Brown Shoe Co. v. United States*, 240 U.S. 251, 258 (lack of finality "of itself alone furnished sufficient ground for the denial").

In *Brotherhood of Locomotive Firemen and Enginemen v. Bangor & Aroostock R. R. Co.*, 389 U.S. 327 (1967), the Court stated:

> Petitioners seek certiorari to review the adverse rulings made by the Court of Appeals. However, because the

> Court of Appeals remanded the case, it is not yet ripe for review by this Court. The petition for a writ of certiorari is denied. See Hamilton-Brown Shoe Co. v. Wolf Brothers & Company, 240 U.S. 251, 257-258, 36 S.Ct. 269, 271, 60 L.Ed. 629 (1916).

Defendants' contention that this case is ripe for review by this Court misconceives the function of the trial and appellate courts. The trial court (or jury) initially determines what the facts are. See, e.g., *Sartor v. Arkansas Natural Gas Corp.*, 321 U.S. 620 (1944). Appellate courts sit as courts of review. Their function is to review alleged errors, not to search out the facts or to try actions *de novo*. See, *e.g.*, *Sartor v. Arkansas Natural Gas Corp., supra; Williams v. National Sur. Corp.*, 257 F.2d 771 (5th Cir. 1958); *Birmingham Post Co. v. Brown*, 217 F.2d 127 (5th Cir. 1955); *Empire Dist. Elec. Co. v. Rupert*, 199 F.2d 941 (7th Cir. 1953), 345 U.S. 909; *Dowell v. Jowers*, 182 F.2d 576 (5th Cir. 1950); *Arstein v. Porter*, 154 F.2d 464 (2d Cir. 1946).

These well-established principles are particularly appropriate here, where the court below has remanded the case to the district court for reconsideration in light of the facts which the district court previously declined to consider and where the trier of fact—in this case, a jury—has not yet resolved any factual disputes which may arise. The purpose of a remand is to allow the facts to be authoritatively established in the district court. Where facts now in the record have not been fully considered, where a trial has not been held, and where a jury has not resolved issues of disputed fact, appellate courts should not render hypothetical opinions. *McDonald v. Kershaw, Butler, Engineers, Ltd.*, 172 F.2d 798 (5th Cir. 1949).

The court of appeals has *not* decided that the "VIP" contracts in question are securities nor has it indicated a view. The court of appeals below has simply held: (A) that the district court erred in dismissing Counts 1, 2 and 3 of the

complaint on the ground that they fail to state a cause of action under the Securities Act of 1933 and the Securities Exchange Act of 1934 (which defendants do not appear to seriously dispute in their petition); and (B) that the district court, in passing on any motion for summary judgment, must take into account *all* of the facts, including facts extraneous to the language of the contract, such as the written sales material, oral sales presentations and expert testimony on the nature of the benefits offered, the cost of the "insurance" benefits, and the "load" for non-insurance benefits of an "investment" nature.

The defendants cite various books of a technical nature dealing with insurance in their petition in this Court (as they did in their briefs below) to argue that the provisions of the "VIP" contracts are "standard" and that the cost of the benefits offered is comparable to the cost of similar endowment benefits offered by major insurance companies.[10]

At oral argument before the court of appeals *en banc*, that court quite properly rejected defendants' efforts, noting that the books were not in the record on appeal, that insurance provisions vary widely, and that any attempt to offer "expert" testimony should be made at the trial court, where the expert can be subjected to cross-examination, rather than on appeal.

In remanding the case, the court of appeals followed sound appellate practice, recognizing that it ought not decide facts in a vacuum or function *de novo* as the arbiter of fact. And

[10] Remand is also particularly approriate in view of some of the arguments urged by defendants in their petition. For example, at p. 14 of the petition, defendants offer comparisons of the "VIP" contracts with Metropolitan Life's "participating" insurance contracts (as to which comparison no evidence exists in the record). At pages 45 and 10-14 of their petition, defendants go outside the record to call upon this Court to function as a *de novo* fact finder, with the assistance of its "common knowledge," to accept certain propositions about the insurance business which defendants assert to be true.

clearly, the November 17, 1977 order vacating the grant of rehearing *en banc* after full briefing and oral argument before the entire court of appeals suggests that the case is not ripe for appellate review and the rehearing petition was meritless. For these same reasons, this Court should not grant *certiorari*.[11]

If the questions presented by defendants' petition are as important as they urge, then would it not be more appropriate for this Court to consider those questions upon the basis of a complete record, including testimony by experts, as suggested by the court of appeals below?

II

Ample Authority Supports the Panel's February 18 Holding That the Parol Evidence Rule Cannot Be Applied in This Case to Bar the Receipt of Evidence of Oral and Written Representations.

As the United States Supreme Court has held, in *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 351-353 (1943):

> "In the enforcement of an act such as this, it is not inappropriate that promoters' offerings be judged as being what they were represented to be."

---

[11] Defendants' argument (at p. 3 and at p. 21) that the court of appeals has departed from accepted appellate practices and has imposed undue expense upon the defendants by vacating the *en banc* rehearing and remanding this case to the district court is particularly meretricious. The rehearing petition was defendants' idea—not respondents'—and plaintiffs do not bear the blame where the court, *en banc*, found the rehearing petition to be meritless and where the panel then held that the defendants' rehearing petition had misrepresented the panel's original opinion. Indeed, the expense of defendants' meritless rehearing petition was far more unfair to plaintiffs. For defendants to convert their inaccurate rehearing petition into an argument for a trial *de novo* in this Court to save them expense is utterly without logic.

Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), Rule 10b-5, and Section 12(2) and Section 17(a) of the 1933 Act, 15 U.S.C. §§ 77l(2) and 77q(a), prohibits frauds in connection with "offerings" as well as "sales" of securities. The Congressional prohibition against fraud in connection with offerings was designed to prevent defendants from avoiding the "anti-fraud" provisions by failure to deliver the "security" promised. The provisions of the Act "cannot be evaded by simply refraining from issuing to the subscriber any documentary evidence of his interest." House Committee Report No. 1338 (Conference Report), 73rd Cong., 2d Sess., p. 39. Cf. *Goodman v. H. Heintz & Company*, 265 F.Supp. 440, 444 (N.D. Ill. 1967), in which the Court upheld the complaint based upon alleged violation of the antitrust provisions of the 1934 Act, notwithstanding the fact that the "security" was nonexistent or fictitious, and was never delivered to plaintiff. If non-delivery of any instrument representing the "security" is not a defense, it would seem that the delivery of an instrument different from that promised should also not be a defense.

In *Svalina v. Big Horn National Life Ins. Co.*, 466 P.2d 1018 (Wyo. 1970), the Supreme Court of Wyoming reversed the trial court's action in directing judgment for defendant under facts quite similar to those presented here. The plaintiff testified in that case that he had understood over a period of years that he was buying "stock" in the insurance company when he was in fact delivered a policy of insurance. The Supreme Court of Wyoming quoted with approval the following language from an article by Kimball & Hanson, "The Regulation of Specialty Policies in Life Insurance," 62 Mich. L. Rev. 167, 204 (1963):

> "The emphasis on investment and a high rate of return tends to mislead the purchaser into believing that he is acquiring primarily an investment rather than a life insurance policy. The market success of some life insurance stocks prepares the way for even more striking deceptions,

and some sales presentations are so successful that they convince the purchaser that he is acquiring stock in the company."

Under facts somewhat similar to those in the present case, in *Southern Bldg. & Loan Ass'n v. Dinsmore*, 225 Ala. 550, 551-552, 144 So. 21, 22-23 (1932), the Supreme Court of Alabama held that the affirmative charge was properly refused the defendant, stating:

> "The action is for deceit in the sale to plaintiff by defendant, through its agent, of a 'surplus certificate' which was *represented as stock in defendant corporation* of the value of $500, bearing 8 per cent interest, and which could be cashed or surrendered to defendant at any time, plaintiff receiving the $500 with interest.
>
> * * * * * * *
>
> The argument for the affirmative charge is rested upon the possession by the plaintiff of the surplus certificate continuously from the time of its delivery to him and a knowledge of its contents imputed to him by law. But plaintiff did not read the certificate and there is no evidence he had any actual knowledge of its contents, and his proof tends to show that he was lulled into a feeling of security and into any neglect to read the same by the misrepresentations of the agent. Under these circumstances the law imputes to him no knowledge of its contents." [Emphasis added.]

In another case involving a contract sold by an insurance company, the Supreme Court of Alabama stated in *Commercial Cas. Ins. Co. v. Hosey*, 238 Ala. 335, 336-337, 191 So. 343, 344-345 (1939):

> ". . . The complainants had a right to assume that the policy covered the losses as agreed between the parties.
>
> * * * * * * *

> The failure of the insured to read the policy was not a violation of a positive duty which the insured owed the insurer, and therefore, was not such negligence as will bar the complainants' right to reformation."

Where one party is guilty of fraud in the inducement, parol evidence is always admissible to reform the written document later delivered to the plaintiff so as to conform to the actual understandings of the parties at the time of the transaction.

The foregoing is not new law, nor is it something which should come as a surprise to the defendants in this action. See 17 Couch on Insurance, Section 66:42 at pp. 278-280 (2d Ed. 1967):

> "Where the insurer's agent is authorized to act in the premises, and through his mistake or fraud the policy failed to express the real contract between the parties, or if, by inadvertence or mistake of the agent, provisions other than those intended are inserted, or stipulated provisions are omitted, there is no doubt as to the power of a court of equity to grant relief by reformation of the contract, at least, where there is no fraud or collusion between the agent and the insured. In other words, where a policy of insurance does not represent the intention of the parties solely because of some fault or negligence of an agent of the insurer, equity will reform it so as to make it express such intention."

In *Kansas City Life Ins. Co. v. Cox,* 104 F.2d 321, 324-325 (6th Cir. 1939), construing the law of Alabama, the Court of Appeals noted:

> "Insurance policies, unlike other contracts, do not bear the signature of the assured, and the acceptance of a policy, without noticing a mistake, will not always preclude reformation."

In its February 18 opinion, the panel held that the parol evidence rules does not apply to proof of violations of the federal antifraud provisions in the offering of securities. In the alternative, the panel held in fn. 11 to its February 18 opinion that evidence of the representations made would be admissible under the parol evidence rule itself, in order to prove fraud or in order to explain the meaning of words such as "dividends" and "investment" used in the contracts. See Restatement of Contracts §§233 and 238(b).

The panel was clearly correct.

III

The Decision of the Court of Appeals Below Is Not in Conflict With the Tenth Circuit's Decision in Olpin v. Ideal National Insurance Co., 419 F.2d 1250 (10th Cir. 1969), Cert. Denied, 379 U.S. 1074 (1970).

At p. 17, defendants' petition urges that this Court grant *certiorari* on the theory that the decision below is in conflict with the Tenth Circuit's decision in *Olpin v. Ideal National Insurance Co.*, 419 F.2d 1250 (10th Cir. 1969), *cert. denied*, 397 U.S. 1074 (1970).

Inconsistently, however, the defendants' petition (at p. 17) concedes that the *Olpin* court:

> ". . . dealt with another form of participating provision . . . described as a 'bonus fund endorsement' and was unlike the standard form involved in the present case."

Since the *Olpin* decision dealt with a different contract, this Court need not grant *certiorari* to resolve a conflict between the courts of appeal "on the same matter."

In any event, as noted hereinabove, this case is not ripe for mature consideration by this Court. Any review of this case

by this Court should follow reconsideration and resolution of the facts in the district court and subsequent review by the court of appeals, in the ordinary course of events.

IV

The Concerns Expressed by Defendants in Their Petition for Certiorari With Respect to Whether Standard Insurance, Endowment, and Annuity Contracts Must Be Registered With the SEC, and With Respect to Overlapping SEC and State Regulation, Are Based on a Misunderstanding of Congressional Intent and of the Extent of the Overlap.

Defendants' petition (at p. 8-16) expresses concern that standard annuity, endowment and insurance contracts must be registered with the SEC by virtue of the panel's February 18 opinion. Moreover, defendants argue that the February 18 opinion will create unnecessary "duplication" in regulation of insurance companies by the SEC and state regulatory agencies. The defendants appear to argue that the entire panoply of federal securities laws would apply to standard insurance, endowment and annuity contracts issued by insurance companies already subject to state control. But that conclusion does not flow from the stated premise for two important reasons.

The defendants' petition for certiorari fails to recognize that the applicability of the *antifraud* provisions of the federal securities laws—the provisions primarily relied on by plaintiffs in this action—is separate and distinct from the applicability of the various other provisions of those laws such as the Securities Act's registration provisions, which require the filing of a registration statement with the Commission and the delivery of a detailed prospectus in public offerings of securities. Although the antifraud provisions are generally applicable to all securities, various securities are statutorily exempt from the registration

provisions. In this regard, "any insurance or endowment policy or annuity contract or optional annuity contract" issued by a regulated insurance company is exempt from registration by Section 3(a)(8) of the Securities Act, 15 U.S.C. 77c(a)(8), but Congress expressly provided in Section 17(c), 15 U.S.C. 77q(c), that those exemptions should not, and do not, carry with them any immunity from the antifraud protections the federal securities laws provide all investors. By way of example, in *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959), the United States Supreme Court reasoned in the majority opinion that:

> ". . . the term 'security' is broad enough to include any 'annuity' contract. . . ." 359 U.S., at 67-68.

It follows that any "annuity" contract is subject to the antifraud provisions of the 1933 and 1934 Acts. That, however, is only the first step in the analysis which must be made. The Court went on in *SEC v. VALIC, supra*, to consider whether, under all the facts, the "Variable Annuity Life Insurance" contracts were within the exemption from *registration* for "any insurance or endowment policy or endowment contract or optional annuity contract." Based upon an economic analysis of the nature of the contracts in question, in *VALIC* this Court held variable annuity contracts were *not* exempt from registration with the SEC, notwithstanding the fact that such contracts were labelled as "insurance" and notwithstanding the fact that the issuer was an insurance company subject to state regulation.

The very fact that Congress drew a distinction between the applicability of the antifraud provisions and the applicability of the registration provisions indicates that Congress intended that the antifraud provisions would be applicable to "exempt securities," notwithstanding the fact that the issuer is an insurance company subject to regulation by state insurance authorities.

Similarly, in Section 12(g) of the Securities Exchange Act, 15 U.S.C. § 78*l*(g), and in Section 2(a)(17) of the Invest-

ment Company Act of 1940, 15 U.S.C. § 80a-2(a)(17), the problem of an overlap between regulation by the SEC and state agencies was specifically dealt with by Congress in a manner which differs from the result argued for by defendants in their petition. Rather than excluding insurance companies from regulation, Congress granted limited exemptions. Significantly, the antifraud provisions are not included among the areas left entirely to state regulation. Under the approach adopted by Congress, investors in securities issued by insurance companies retain the protections of the antifraud provisions, which provide needed safeguards against false and misleading representations made to investors and which have been held to grant private rights of action to injured investors.

U. S. Government obligations, municipal bonds and "insurance contracts" are exempted from registration with the SEC by § 3 of the 1933 Act. The exemptions provided by § 3, however, do *not* apply to the antifraud provisions. See §§ 12(2) and 17 of the 1933 Act and § 10(b) of the 1934 Act.

Thus, a fraud committed in connection with the purchase or sale of U.S. Government debt securities has been held to be actionable under SEC Rule 10b-5, even though (a) U. S. Government obligations are exempt from registration; and (b) the defendant was an insurance company. See *Supt. of Ins. as Liq. of Manhattan Cas. Co. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971).

Congress itself characterized the contracts exempted by § 3a (8) as "classes of securities." Section 3(a)(8) of the 1933 Act, 15 U.S.C. § 77c(a)(8) states:

> "Except as hereinafter expressly provided, the provisions of this title shall not apply to any of *the following classes of securities:*
>
> * * *

(8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any state or territory of the United States or the District of Columbia . . ." [Emphasis added.]

As noted above, § 3(a)(8) exempts insurance or annuity or endowment contracts from registration, but does not exempt such contracts from the antifraud provisions of the Securities Act, § 12(2) and § 17. Section 12(2) provides, in pertinent part:

"Any person who . . . offers or sells a security (*whether or not exempted by the provisions of section 3* [*of this Act*] *other than paragraph (2) of subsection (2) thereof*), by the use of any means of instrument of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity . . ." [Emphasis added.]

Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a) (which makes it unlawful for any person by the use of the mails or other interstate facilities to obtain money or property by any untrue statement of a material fact or any omission to state a material fact in the offer or sale of any securities), expressly provides:

"The exemptions provided in section 3 shall not apply to the provisions of this section."

Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10), which defines "security" for purposes of the 1934 Act, contains no exemption for insurance contracts, but §3(a)(12) of the 1934 Act, 15 U.S.C. §78(a)(12) defines "exempted securities" to include certain annuity plans.

It is apparent that the intent of Congress was to exempt insurance policies (and government bonds) from *registration*, but not to exempt government bonds or securities issued by insurance companies from the *antifraud* provisions. See, *e.g.*, *SEC v. National Securities, Inc.*, 393 U.S. 453, 468-469 (1969).

V

The Decision Below Is Wholly Consistent With This Court's Prior Decisions; the McCarran-Ferguson Act (Adopted in 1945) Does Not Bar the Application of the Federal Securities Laws to the "Variable Investment Plan" Contracts Sold Plaintiffs in This Action.

Defendants argue (at p. 14 of their petition) that the "VIP" contracts are exempted from the antifraud and registration provisions of the federal securities laws by the McCarran-Ferguson Act, 15 U.S.C. §1012, adopted in 1945, which states:

"(a) The *business of insurance*, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business. (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating *the business of insurance*, or which imposes a fee or tax upon such business, *unless such Act specifically relates to the business of insurance; Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of

> October 15, 1944, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law." [Emphasis added.]

By virtue of the McCarran-Ferguson Act, if any Act of Congress is *silent* with respect to insurance, the Act may not be construed so as to invalidate, impair or supersede state laws regulating the "business of insurance."

As we shall show below, the McCarran-Ferguson Act does not require affirmance of the district court's order, for the following reasons:

(a) Only the "insurance business" is dealt with by the McCarran-Ferguson Act. This Court's decisions make it clear that the finder of fact must decide, based on all the evidence, whether particular contracts sold by an insurance company are merely "insurance" or are something other than mere "insurance." In making that factual determination, the finder of fact may properly consider not only the language of the contract, but also the sales representations made, the relationship between the size of the "premiums" paid and the size of the death benefits,[12] and other economic inducements and characteristics of the contracts in question.

---

[12] As the panel's February 18 opinion at fn. 12 suggests, the gross annual payments made to Great States by the plaintiffs in this action far exceeded the industry norm for the $10,000 death benefits provided under the "Variable Investment Plan" contracts. Plaintiff Parsons paid $477.87 per year for a contract which included a $10,-000 death benefit if his three-year old child died. He was told he would receive "profit-sharing" checks totalling $23,145 on the contract over a 25 year period. (App. 158-158 A).

It is interesting to note that Congress exempted from SEC registration any contract providing for life insurance issued prior to March 23, 1949 (the date of the *VALIC* decision), but only if no more than 49% of the premium or other consideration paid for such contracts was to be allocated to a profit-sharing fund. See P.L. 91-547, §29, quoted herein at fn. 13.

(b) The 1933, 1934 and 1940 Acts of Congress, as amended, *specifically* deal with the business of insurance. Each such Act recognizes and provides for the possible application of such Act to insurance and insurance companies, and includes specific but carefully limited exemptions.

(c) The 1933 and 1934 Acts are cumulative to state regulation and do not "invalidate, impair or supersede" state laws regulating or taxing the business of insurance. See §28 of the 1934 Act and §§ 16 and 18 of the 1933 Act. See also §50 of the 1940 Act.

A. **McCarran-Ferguson is not dispositive of the factual questions presented in this action: Are the V.I.P. contracts merely "insurance contracts"? Do they only involve the "business of insurance"?**

The U. S. Supreme Court's decisions in *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969); *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967); and *SEC v. Variable Annuity Life Ins. Co.*, make it clear that the McCarran-Ferguson Act does *not* foreclose a factual inquiry with respect to whether particular contracts are "insurance" or something *other* than the "business of insurance."

All three of those decisions were handed down *after* the adoption of the McCarran-Ferguson Act in 1945.

In the last two cases, where no demand for trial by jury of factual issues was involved, the United States Supreme Court, after careful analysis of all the facts, held that "Flexible Fund" contracts and "Variable Annuities," were "securities" subject to registration under the 1933 Act notwithstanding McCarran-Ferguson, notwithstanding §3(a)(8) of the 1933 Act, and notwithstanding the fact that the contracts included significant "insurance" benefits.

In *VALIC*, Justice Brennen observed:

> "Obviously they have elements of conventional insurance, even apart from the fixed-dollar term life insurance and the disability waiver of premium insurance sold with some of these contracts (both of which are quite incidental to the main undertaking). They patently contain a significant annuity feature (unless one defines an annuity as a contract necessarily providing fixed-sum payments), and the granting of annuities has been considered part of the business of life insurance.
>
> * * * * * * *
>
> "The contract uses insurance terminology throughout and many of the common features of life insurance and annuity policies are operative in regard to it at this 'pay-in' stage. There are 'incontestability' and 'suicide' clauses (which mainly relate to the term insurance); a 'grace period' allowed for the payment of premiums; a provision for 'policy loans' . . . and a provision for a 'cash value'
>
> . . . And very certainly the commitment of the company eventually to disburse the accumulated values on a life annuity basis once the pay-in period is over is present throughout this period." *SEC v. Variable Annuity Ins. Co.*, 359 U.S. at 80-81, 84. (Brennen, J., concurring.)

Thus, the U. S. Supreme Court declined to foreclose a factual analysis in *VALIC* and *United Benefit*, even though the contracts sold included many "insurance-type" features such as fixed death benefits.

In *VALIC*, the Court noted:

> "The basic difference between a contract which to some degree is insured and a contract of insurance must be recognized."

In *United Benefit*, the Court not only made an economic analysis of the contract, but also looked at sales representations made:

> "United's primary advertisement for the 'flexible fund' was headed 'new opportunity for financial growth.' United's sales aid kit included displays emphasizing the possibility of investment return and the experience of United's management and professional investing." 378 U.S. at 211, n. 15.

Based on *all* the facts, the Supreme Court held in *VALIC* and *United Benefit* that the contracts before it were not merely "insurance" or "annuity" contracts, and, therefore, were not exempt from registration with the SEC by virtue of §3(a)(10) of the 1933 Act or McCarran-Ferguson.

B. **The 1933, 1934 and 1940 Acts expressly deal with the business of insurance.**

Congress recognized that the term "securities" as defined by §2(1) of the 1933 Act, 15 U.S.C. 77b(1), was broad enough to include insurance and annuity contracts. Congress provided by Section 3(a)(8), 15 U.S.C. 77c(a)(8), that the *registration* requirements would not apply to "any of the following *classes of securities*: . . . (8) Any insurance or endowment policy or annuity contract."

As originally enacted, the 1933 Act very carefully exempts "any insurance . . . contract" from registration, but the exemption is available *only* if certain conditions are met. To be exempt, the contract must (a) be issued by a corporation; and (b) the corporation must be subject to the supervision of the insurance commissioner (or like agency or officer) of a state or territory of the United States or of the District. Moreover, the exemption provided by Section 3(a)(8) does *not* apply to

violations of Section 12(1) of the 1933 Act or to violations of Section 17 of the Securities Act of 1933.

Since the enactment of the McCarran-Ferguson Act on March 15, 1945, the 1933 Act has been amended several times. Following the March 23, 1959 decision by the Supreme Court in *VALIC*, Congress adopted a statute[13] which exempted from SEC registration certain, but not all, insurance contracts issued prior to March 23, 1959. Congress left in effect the *VALIC* decision with respect to contracts issued after March 23, 1959. Thus, Congress in 1959 impliedly recognized that a factual inquiry is proper to determine whether particular contracts should be exempt from SEC registration. Moreover, Congress impliedly recognized that registration with the SEC of contracts other than mere "insurance" may be required notwithstanding McCarran-Ferguson and §3(a)(8) of the 1933 Act.

After the enactment of the McCarran-Ferguson Act in 1945, the 1934 Act was amended in 1945 to include Section 12(g) of the 1934 Act, 15 U.S.C. §78l(g), which required insur-

---

[13] Section 29 of Pub.L. 91-547 provided that:

"The provisions of the Securities Act of 1933 and the Investment Company Act of 1940 shall not apply, except for purposes of definition of terms used in this section, to any interest or participation (including any separate account or other fund providing for the sharing of income or gains and losses, and any interest or participation in such account or firm) in any contract, certificate or policy providing for life insurance benefits *which was issued prior to March 23, 1959*, if (1) the form of such contract, certificate, or policy was approved by the insurance commissioner, or similar official or agency, of a state, territory or the District of Columbia, and (2) under such contract, certificate, or policy *not to exceed 49 percent* of the gross premiums or other consideration paid was to be allocated to a separate account or other fund providing for the sharing of income or gains and losses. Nothing herein contained shall be taken to imply that any such interest or participation constitutes a 'security' under any other laws of the United States." [Emphasis added.]

ance companies to register with the SEC *unless all of the following conditions are met*:

> "(i) Such insurance company is required to and does file an annual statement . . . and such annual statement conforms to that prescribed by the National Association of Insurance Commissioners. . . .
>
> (ii) Such insurance company is subject to regulation by its domicilary state of proxies, consent, or authorization in respect of securities issued by such company and such regulation conforms to that prescribed by the National Association of Insurance Commissioners.
>
> (iii) After July 1, 1966, the purchase and sale of securities issued by such insurance company by beneficial owners, directors, or officers of such company are subject to regulations (including reporting) by its domicilary state substantially in the manner provided in Section 16 of this Act [15 U.S.C. §78p]." Securities Exchange Act of 1934, Section 12(g)(2)(G), 15 U.S.C. §78l(g)(2)(G).

Section 2(a)(17) of the Investment Company Act of 1940, 15 U.S.C. §80a-2(a)(17) defines an "insurance company" for the purpose of certain exemptions, but carefully limits those exemptions to a company:

> ". . . whose *primary and predominant* business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies."

C. **The 1933 and 1934 Acts are cumulative to state regulation and do not "supersede, impair or invalidate" state laws regulating or taxing the business of insurance.**

The federal securities laws *supplement* state regulation, but do not *supersede* state regulation. Those who sell securities

must comply with both federal and state laws in the event the mails or instrumentalities or facilities of interstate commerce are used.

Thus, §§ 16 and 18 of the 1933 Act, §28 of the 1934 Act, and §50 of the 1940 Act make it clear that nothing in those Acts is intended to preclude state regulation, and that the remedies afforded by federal law are intended to be available in addition to all other remedies which investors may have under state law.

As Mr. Justice Brennan observed in ***VALIC:***

> ". . . Concurrent regulation, then, was contemplated by the acts as a quite generally prevailing matter. Nor is it rational to assume that Congress thought that *any* business whatsoever regulated by a specific class of officials, the State Insurance Commissioners, would be for that reason so perfectly conducted and regulated that all of the protections of the Federal Acts would be unnecessary. This approach of personally selective deference to the state administrators is hardly to be attributed to Congress. . . ."

In ***VALIC, United Benefit*** and ***National Securities,*** the Supreme Court rejected the notion that state regulation "preempts" federal securities jurisdiction over contracts which have an "investment" feature, as well as an "insurance" feature.

Thus, the panel's February 18 opinion is wholly consistent with the McCarran-Ferguson Act, the carefully drawn exemptions provided in the 1933, 1934 and 1940 Acts, and controlling decisions of the United States Supreme Court.

VI

This Case Is Not of Such Importance as to Require Review by This Court Because It Involves a "Specialty," Non-Standard Contract With Special Provisions Which the States Have Prohibited Since 1967.

Great States "Variable Investment Plan" contract is not, as defendants argue, a "standard" contract. It included "coupons" which since 1967 have been prohibited by all or virtually all State regulatory agencies on the ground that such coupons tend to mislead the purchaser. (App. 168, 127, 64). See Departmental Regulation No. 17, Regulations of Alabama Department of Insurance (April 20, 1967, eff. June 1, 1967). Moreover, the word "Investment" was used in the title of the contract and sales materials were developed and used which were designed to emphasize the investment feature of the contract.

The decision of the court of appeals below does not, therefore, affect *all* insurance contracts sold in the United States, as defendants suggest.

The decision below is unexceptional. It followed sound precedent, and did not break "new ground." The decision below dealt with facts (and a contract) unique to this case. This Court need not take up its time with a contract which State regulatory agencies refuse to permit to be sold as "insurance" because it is sold as an "investment" and is misleading.

VII

State Remedies and State Regulation Are Inadequate.

In their petition for certiorari (at pp. 7-8), defendants L. W. Nimmo, et al. argue that plaintiffs should be foreclosed from proceeding in federal court because they have filed lawsuits in

the state courts. The only defendant in the state court suits is the issuer, State Security, which is insolvent. Defendant Nimmo could not be served in Alabama.

In their petition for rehearing before the court of appeals (at pp. 7-11), defendants argued that the application of the anti-fraud prohibitions and registration requirements of the federal securities laws to contracts sold by insurance companies was not necessary because of the existence of state regulation:

> "Such a result [civil remedies under the securities laws] when dealing with such a large segment of the economy as represented by insurance policies, would seem to add a clearly *unnecessary* burden on both the SEC and the courts when the original intent of regulation of the insurance business was to have that burden assumed by the various state regulatory agencies." Appellees' Petition for Rehearing, page 7. [Emphasis added.]

As we shall show below, state remedies and state regulation are inadequate, and investors who are defrauded *by the use of the mails* should be given a *federal* remedy.

A. **State regulation of investments by insurance companies is not uniform and has not prevented failures of insurance companies and misuse of other people's money by insurance companies and promoters.**

Defendants argued below, in their petition for rehearing,

> ". . . *prescribe primarily that investments must be in fixed income securities and mortgages.*" Appellees' Petition for Rehearing, p. 11 [Emphasis added.]

Defendants' suggestion that insurance companies may invest only in gilt-edged bonds and mortgages is incorrect both as a

general proposition and on the facts of this case. Defendant State Security's capital has been declared impaired. Its assets included a cemetery and a loan on property in Mexico (see Exhibit 1 to Nimmo's deposition, and *Skinner v. White,* 505 F.2d 685 at 686 (5th Cir. 1974).

State regulation varies widely from one State to the next, and egregious frauds and failures have occurred notwithstanding state regulation.

Best's Insurance Reports, Life-Health, 1976 (hereinafter Best's 1976], reveals that last year there were 1,836 life insurance companies domiciled in the United States, with $60,980,000,000 in total annual premium income. This indicates an explosive growth since 1950, when there were only 611 life insurance companies, with $7,607,000,000 in total annual premium income. Best's, 1976, at vii, ix; Hanson and Farney, *Life Insurance Companies: Their Promotion and Regulation,* 49 Marq. L.Rev. 175, 176 (1965) [hereinafter Hanson]. Thus, the insurance industry has expanded by 1,225 active companies since 1950, with an increase of annual premium income of over 50 billion dollars.

As remarkable as these figures are, they do not indicate the number of insurance companies which have failed or otherwise disappeared, nor do these figures indicate the losses sustained by the public. One commentator notes that life insurance companies have shown "two outstanding characteristics: a high birth rate and high mortality rate." Hanson at 177. An analysis of Best's Insurance Reports for 1960 through 1976, discloses the following statistics on life insurance companies organized from 1945 to 1976:

	Life Insurance Companies
(1) "Dissolved," "certificate revoked," "withdrew," "placed in receivership," etc. (without mention of reinsurance), to-wit:	353
(2) "Entered agreement of reinsurance and dissolved," "all business assumed," "reinsured by," "purchased and reinsured by," etc., to-wit:	498
(3) "Merged," to-wit:	877

Taken with the number of existing companies as of 1976 (1,836), the total of the changes in status enumerated above (1,726) show the protean nature of the insurance industry since the adoption of the McCarran-Ferguson Act. This volume of corporation transformations, the majority of which are interstate in nature (Best's, 1960, through Best's, 1976), has placed an impossible burden upon state regulators and state courts. In the words of David M. Pack, Commissioner of Insurance and Banking for the State of Tennessee:

> "Senator, in regard to the interstate aspects of these transactions . . . I have stated that I do not feel that any State insurance department can effectively pursue across State lines the problems that arise under the circumstances." *Hearings*, 91st Cong., at p. 9039.

Some corporate mergers, reinsurance agreements and transfers of assets between insurance companies appear to have been undertaken simply in order to keep those who defraud the public one step ahead of the State. As Allan W. Horne, Arkansas Insurance Commissioner, remarked:

> "Asset juggling and fraudulent securities may take as many forms as the ingenuity of the entrepreneur is capable." *Hearings*, 91st Cong., at p. 8817.

> "There were some rented securities that these three companies [Nebraska, Arkansas and Minnesota] simply rented from someone." *Hearings*, 91st Cong., at p. 8842.

A large number of recently formed companies are controlled by promoters who measure their own achievements "not in terms of policyholder benefits, but in terms of stock appreciation . . .". Hanson, at 177. Thus, one commentator has noted:

> "[A] merger possesses no inherent qualities which compels automatic acceptance of its desirability and worth. Some mergers may be motivated solely for the purpose of enhancing the value of the stock with little regard for its impact upon policyholders' interest. For example, it is not unheard of for an influential member of the board or management of the merged company to receive extra value for his stock unbeknown to other persons in the company." Hanson, at 298-299.

Even mergers, which might seem to be the most innocuous of the transactions set out above, may work to the detriment of the policyholders. What Best's politely terms a "withdrawal" (see category (1) above) needs no explanation.

To place the foregoing statistics in proper perspective, it must be borne in mind that each of the 1,726 companies which failed, merged or withdrew, had a large number of contractholders or policyholders who had paid their monies to that company in the expectation of receiving future benefits. Furthermore, these statistics do not reflect the extent of the dubious practice of shifting blocks of assets, through reinsurance and merger agreements, as to which great concern has been expressed (see generally, *Hearings*, 91st Cong.), because the nature of such transactions makes precise analysis difficult.

The instant case provides a concrete illustration of potential abuses. The plaintiffs originally purchased "Variable Investment

Plan" contracts from Great States Life Insurance Company ("Great States") of Quincy, Illinois. In 1968, Great States was merged into State Security of Indiana. As a result of a 1968 merger with Dependable Life Insurance Company of Mobile, Alabama, State Security assumed substantial obligations to Dependable's policyholders, and acquired as an asset a cemetery (rather than the "fixed income securities and mortgages" referred to at p. 11 of defendants' petition for rehearing below). In another lawsuit arising from alleged diversion of perpetual care funds, State Security was subjected to a $468,408 judgment for contempt. See *Skinner v. White*, 404 F.2d 685 (5th Cir. 1974). Thus, plaintiff-appellants, who had no personal dealings with Dependable Life, were subjected to substantial risks because State Security engaged in a 1968 merger with Dependable (over which the plaintiffs had no control and against which plaintiffs had no readily apparent state remedy).

Moreover, in connection with the 1968 merger of Great States and State Security, plaintiffs' complaint alleges that L. W. Nimmo, a defendant herein, was paid a substantial premium for his stock, out of assets of Great States (presumably purchased with moneys paid in by purchasers of Great States' "V.I.P." contracts). This was accomplished by the device of a loan by a bank to State Security of the moneys which were paid to Nimmo; the bank loan was then repaid after the merger with the proceeds realized from the sale of bonds and other assets of Great States. Thus, the plaintiffs were damaged by the 1968 merger of Great States into State Security.

That was not to be the end of plaintiffs' misfortunes. In 1975, while this appeal was pending, State Security's capital was declared to be impaired, and substantially all of State Security's assets were acquired by Life Insurance Company of Arizona under a Treaty of Bulk Reinsurance. Accordingly, plaintiffs, who had purchased contracts of an Illinois company, now find themselves having to look to an Arizona company, by virtue of

various mergers and reinsurance transactions. We understand that the Arizona company has not qualified to do business in Alabama or Indiana.

B. **The civil remedies available to plaintiffs under state law are inadequate.**

Must plaintiff-appellants now go to Arizona in order to seek redress from a company which has acquired most of State Security's assets? Can Arizona assert jurisdiction over defendants and class members not found within its borders? Cf. *Feldman v. Bates Mfg. Co.*, 143 N.J. Super. 84, 362 A.2d 1177 (1976), in which a State court concluded that it should not certify a class action because it did not have jurisdiction over non-resident class members.

We respectfully submit that an effective remedy should be afforded the plaintiffs and others who were defrauded by the defendants' use of the United States mails. The facts of this case demand the application of nationwide service of process and the national class action remedy available for violations of the antifraud provisions of the federal securities laws.

If a federal remedy is not available, then citizens of the United States may be defrauded by the use of the mails with impunity and may faithfully pay part of their earnings to a life insurance company, only to find themselves with a worthless contract and no adequate remedy. As we have shown above, Congress did not intend by the McCarran-Ferguson Act or by Section 3(a)(8) of the 1933 Act to grant a license to steal, permitting unscrupulous promoters to defraud the public by use of the mails and escape the consequences by raising the shield of "insurance."

C. **Many States do not compel adequate disclosure.**

Some insurance companies have deliberately chosen to offer and sell "specialty" contracts with provisions which cannot be readily compared with other contracts, so as to avoid cost-comparisons by the purchasers. See Kimball and Hanson, "The Regulation of Specialty Policies in Life Insurance," 62 Mich. L.Rev. 167 at 173 (1963):

> "For example, one spokesman for companies issuing specialty policies [a Mr. Ritter, Assistant Secretary of Lincoln National Life Insurance Company of Fort Wayne, Indiana] said:
>
> > 'For the smaller company to meet low-cost competition head-on with the same plan always places them in a tough [competitive] position. This should be avoided, if possible, by the use of unique plans which do not permit comparison with the low-cost Ordinary life policies . . .".

State regulatory agencies, by and large, have not been able to deal adequately with fraudulent and deceptive practices by life insurance companies.

As Dr. Joseph M. Belth, Professor of Insurance, Graduate School of Business, Indiana University, warned:

> "Deceptive sales practices flourish in the sale of conventional life insurance and thus far the states have not shown the willingness to take strong, affirmative action to eradicate such practices. The potential for deception in the sale of the even more complex variable life insurance is frightening to contemplate." Hearings Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary: The Life Insurance Industry, 93rd Cong., 1st Sess., pt. 1, p. 553 (1973).

This Court should not countenance or encourage the use of the mails to defraud purchasers of insurance, annuity and endowment contracts, such contracts are not, and should not be, exempt from the antifraud prohibitions of the federal securities laws.

Moreover, any insurance company which deliberately chooses, as herein, to sell its contracts as an "investment," and which charges substantially more than twice the industry norm for the cost of the fixed death benefits, should be required to comply with the registration and prospectus requirements of the 1933 Act. When Congress passed the 1933 Act, it exempted policies of "insurance" from registration with the SEC. Surely, however, Congress did not intend to exempt from registration contracts such as those involved in this case, in which a company appears to have charged more for the "investment" component than the "insurance" component. In *VALIC* and *United Benefit*, this Court held that an investment contract is not exempt from registration merely because it is labelled as "insurance." The contracts herein, sold "with the investor in mind," are clearly outside the limits of traditional insurance, should not be exempt from registration, and certainly should not be exempt from the antifraud provisions.

The result reached by the panel in its February 18 opinion is not only consistent with the statute and with prior court decisions, but is mandated by the facts of this case and a realistic appraisal of conditions in the insurance industry.

CONCLUSION

The Fifth Circuit's opinion below properly remanded this case to the district court for sifting of all the facts pertinent to whether the VIP contracts are "securities." The common sense opinion of the Fifth Circuit expressed no view on that questions, but simply followed well-settled precedent in specifying the facts which should be considered in the district court.

This case is not ripe for review by this Court. Any such review should await reconsideration and resolution of the facts before the district court and subsequent review by the court of appeals in the usual course.

For these reasons, the petition for certiorari should be denied.

Respectfully submitted,

J. VERNON PATRICK, JR.
One of Counsel for Respondents
(Plaintiffs Below)

Of Counsel:

J. VERNON PATRICK, JR.
RICHARD NORTH PATTERSON
THOMAS J. GALLO
BERKOWITZ, LEFKOVITS & PATRICK
1400 City National Bank Building
Birmingham, Alabama 35203
(205) 328-0480

JAMES W. MAY
1122 North 22nd Street
Birmingham, Alabama 35234
(205) 254-3272

CERTIFICATE OF SERVICE

I hereby certify that three copies of the foregoing Brief in Opposition to Certiorari were this date served upon all parties by U. S. Mail to John H. Morrow, Esquire, and Robert R. Reid, Jr., Esquire, of Bradley, Arant, Rose and White, Brown-Marx Building, Birmingham, Alabama, 35203; George R. Stuart, III, Esquire, Hardin, Stuart & Moncus, 413 North 21st Street, Birmingham, Alabama, 35203; and Sidney J. Lavender, Esquire, Johnston, Barton, Proctor, Swedlaw & Naff, Twelfth Floor, Bank for Savings Building, Birmingham, Alabama 35203, counsel of record for defendant Life Insurance Company of Arizona; and Harvey Pitt, General Counsel, United States Securities and Exchange Commission, 50 N. Capitol Street, Washington, D. C. 20549.

This the 9th day of May, 1978.

....